

Developing Workforce Skills: Piloting a New Approach

April 2002



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Developing Workforce Skills: Piloting a New Approach

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Five years ago the Government set its central economic objective of high and stable growth and employment. In the last Parliament we reformed the macroeconomic framework and tackled years of economic instability. Labour market policies have been reformed to open employment opportunities to all, and over a million more people have entered work since 1997. We also began a programme of structural economic reforms aimed at increasing productivity and prosperity for all in the UK.

Building on the successes of policies in the last Parliament, which focused on economic stability and work, we are now also focusing on improving productivity and enterprise. Improving the skills of our workforce is essential to productivity growth. The supply of skilled workers to UK firms is crucial to their international success and long-term prospects. For individuals, skills are a route to more stable employment, better wages, and long-term prosperity, as well as to personal development. Britain has for too long neglected the training and development of its workforce, particularly for those who have lower levels of skills.

The Government is committed to making training opportunities available for all, and to ensuring that the UK has the world-class workforce it needs for the future. This document sets out more details of pilot schemes, announced in the 2001 Pre-Budget Report which will test a new policy approach to support the training of low-skilled workers in the UK, based on shared responsibilities between government, employers and individuals.



Rt Hon. Gordon Brown MP



Rt Hon. Estelle Morris MP

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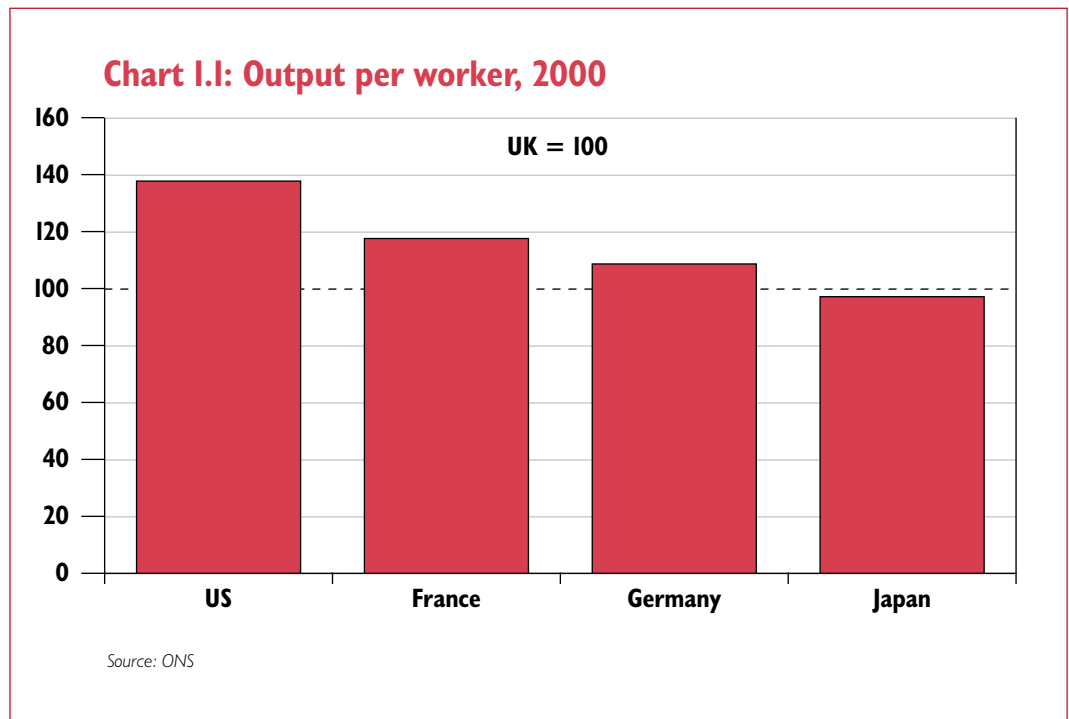
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CONTEXT FOR THE PILOTS: PRODUCTIVITY AND THE UK'S SKILLS BASE

I.1 The 2001 Pre-Budget Report announced pilot schemes to test new approaches to workforce development in the UK. This paper sets out more details of these Employer Training Pilots. The National Skills Task Force analysed UK skills in some depth; recent reports of the Performance and Innovation Unit (PIU) and the joint CBI-TUC productivity working group have built on this work, looking particularly at workplace training issues. This chapter takes up their analysis, while later chapters examine the potential role for government intervention in skill development and set out details of the pilot schemes which will explore how this intervention can best be targeted.

UK PRODUCTIVITY

I.2 Historically, the productivity performance of the UK economy has been relatively weak. Macroeconomic instability and microeconomic failures have inhibited productivity growth and contributed to a substantial productivity gap between the UK and many other advanced industrial economies, as shown in **Chart 1.1**. Productivity improvements are the key to long-term growth and sustained increases in living standards. Increasing productivity and growth is a central aim of this Government.



I.3 Many factors can contribute to productivity improvements, including high levels of enterprise and innovation, high levels of domestic competition, high levels of capital investment, better management and a more highly skilled workforce. The Government's strategy on productivity was set out in *Productivity in the UK: The Evidence and the Government's Approach*, which was published alongside the November 2000 Pre-Budget Report.

THE LINKS BETWEEN SKILLS AND PRODUCTIVITY: EVIDENCE

I.4 There is a well-established relationship between improvements in skills and increased productivity, supported by both theoretical and empirical research. Growth theory suggests that human capital is one of the prime determinants of labour productivity. Human capital is increased both by formal education and training and by learning-through-doing. Growth is centrally driven by the accumulation or stock of human capital, which also, through the embodiment of technical knowledge, provides the basis for innovation.¹

I.5 Skilled workers can often adapt faster and more effectively to change and may be better at implementing new investments and innovation.² They can thus increase the ability of a firm to update its practices and products at the rate demanded by rapidly changing markets, making the economy more flexible and more productive over the longer run.

I.6 The impact of skills on productivity also works partly through effects on capital investment levels. This mechanism was noted by the CBI-TUC Investment Group in their submission to the Government's Productivity Initiative.³ Evidence suggests that having highly skilled workers helps firms gain the full rewards of new investment and thus increases the likelihood that investment will occur.⁴

I.7 Research examining the causes of international productivity performance suggests that differing levels of skills play an important role. For example, estimates have been presented which suggest that between half and all of the UK productivity gap with Germany can be explained by skills differences.⁵

I.8 Evidence at the firm and plant level shows a similar picture. Plants with higher productivity tend to have a higher proportion of skilled workers in their workforces, as shown in **Chart 1.2**. Oulton (2000) finds that differences in physical and human capital can explain around 60 per cent of the productivity gap between domestically owned firms and US-owned firms in the UK, and nearly all of the gap with other foreign-owned firms.

I.9 Estimates of the rates of return accruing to different levels of qualification suggest that employers are prepared to pay significantly more for workers with higher levels of qualifications. Wage data suggests that more highly trained workers are indeed more productive. However, the mechanisms involved are complicated and it would be a mistake to ignore other factors that link individual educational attainment to wages – such as the role which educational qualifications play as signals of desirable characteristics and abilities.

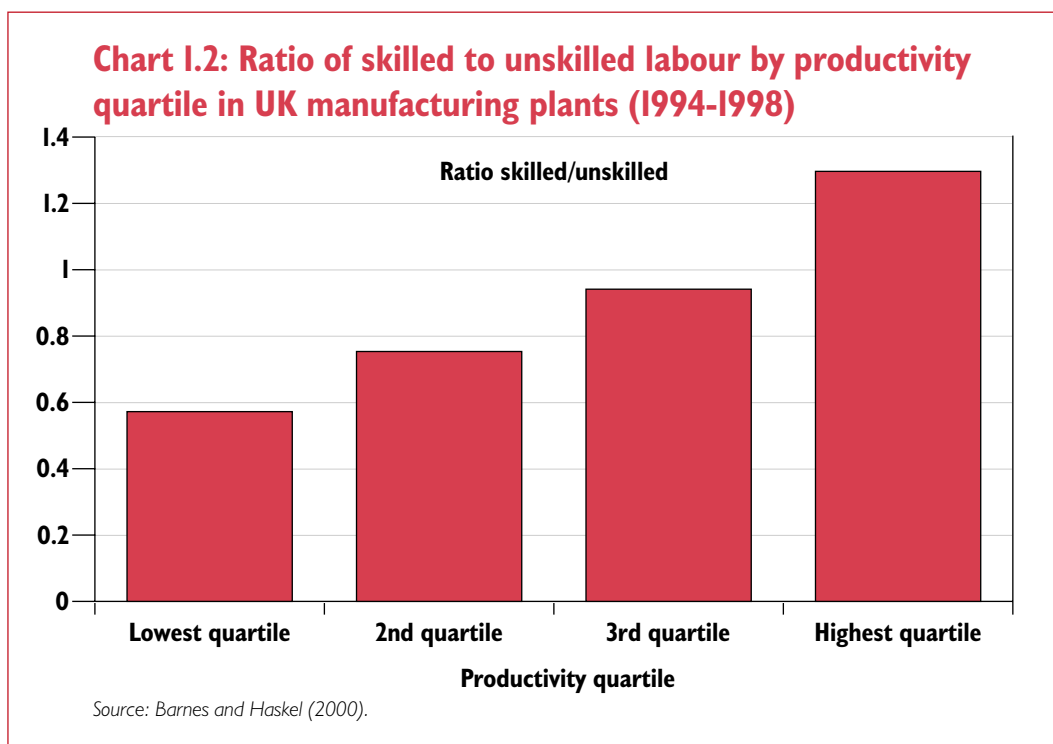
¹ Bassanini and Scarpetta 2001; Krueger and Lindahl 2000; Temple 2000; Aghion and Howitt 1998; Benhabib and Spiegel 1994.

² Cassen and Mavrotas 1997; Laplagne and Bensted 1999.

³ CBI-TUC Submission to the Productivity Initiative 2001, p13.

⁴ See, for example, Layard, McIntosh and Vignoles 2001, OECD 2001 *The Growth Project*.

⁵ O'Mahony 1999, Layard, McIntosh and Vignoles 2001.



I.10 Research at the worker level finds that holding a tertiary qualification (e.g. a degree) in the UK increases productivity by between 30 and 100 per cent when compared to a worker with no qualifications.⁶ Holding an intermediate qualification at NVQ level 3 results in higher productivity of between 8 and 50 per cent when compared to productivity of an unqualified worker.⁷ A level 1 qualification⁸ provides private returns of around 22 per cent for men, and 34 per cent for women. In contrast, a level 2 qualification provides relatively low private returns.⁹

I.11 Evidence also suggests that training is associated with greater productivity gains than wage gains, implying significant returns for employers as well as individuals. The Institute for Fiscal Studies, for example, has shown that a 5 percentage point increase in the proportion of trained workers in an industry leads to average wage gains of 1.6 per cent, compared to 4 per cent increases in value added per worker.¹⁰

⁶ Jenkins 1995.

⁷ Jenkins 1995.

⁸ Qualifications are classified according to five (NVQ equivalent) levels, where level 5 is a postgraduate qualification, level 4 is a degree level qualification, level 3 is equivalent to two 'A' level passes, level 2 is equivalent to five GCSE passes at grades A*-C, and

level 1 is any formal qualification below level 2. Full definitions can be found in "Qualifications data and the Labour Force Survey", Labour Market Trends January 1998, pp33-41.

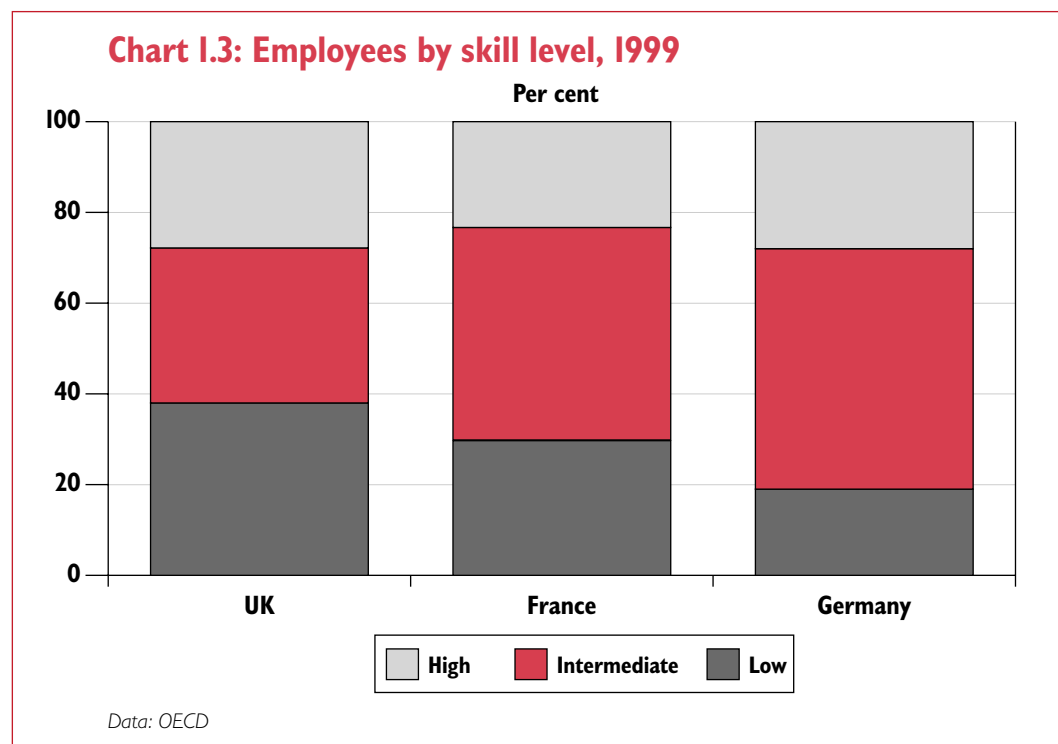
⁹ Labour Force Survey wage data 2000.

¹⁰ Dearden, Reed and van Reenen 2000.

THE UK SKILLS BASE

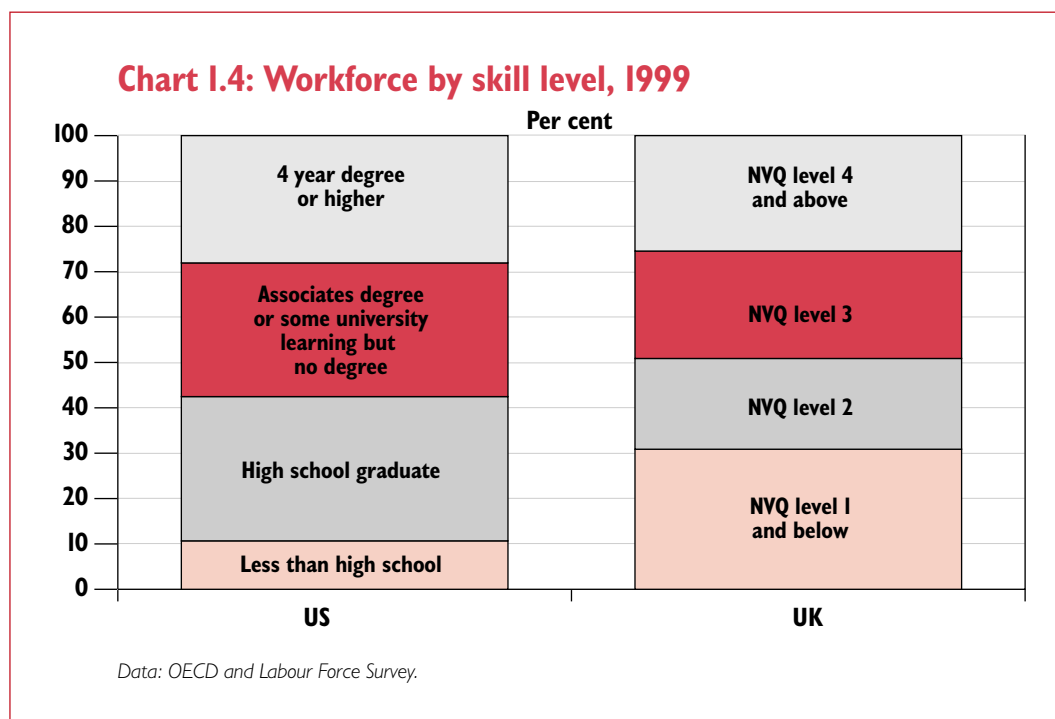
International Comparisons

I.12 The following charts show the international UK position in terms of the relative skill composition of the workforce. **Chart 1.3** suggests that although the UK has a large number of workers with high skills, it falls behind France and Germany in terms of intermediate skills, with a higher proportion of UK workers having low skills.¹¹ More than a third of UK workers have low skills, compared to less than a fifth in Germany.



I.13 It is difficult to make skill comparisons with the US. Education and training in the US is based on state and local systems, and there are very few nationally recognised qualifications. This makes it hard to judge the skill levels of the US workforce: for instance, some studies have shown the US to have a very high proportion of low-skilled workers, while others have suggested that this proportion is very low. **Chart 1.4** seeks to compare the educational achievements of the US and UK workforces.

¹¹ International comparisons of human capital are difficult to make. Some countries do not certify all education and training, and it is difficult to establish equivalencies between different qualification systems where they do exist. International comparisons therefore tend to vary somewhat depending on the interpretation of the evidence, but the position of the UK relative to its main European competitors in terms of intermediate skills appears poor in almost all studies.



I.14 A key difficulty in assessing US skill levels lies in judging the skill levels of high school graduates, since there are no consistent qualification standards across the US, and the quality of high school education varies widely. Some studies have classified this group as low-skilled, others as intermediate-skilled. The 'high school graduate' category conceals a high degree of variation. It is certainly true that some US high school graduates have very low skill levels. It is also true that some high school systems provide young people with high quality vocational and general training, which means that many high school graduates should be classified as 'intermediate skilled'. It is difficult to be certain, but the UK may lag significantly behind the US as well as European countries in terms of intermediate skills.

I.15 It is also important to recognise that the US data includes hardly any adult/workplace training due to the lack of recognised qualification structures, whereas UK data includes much of this training, as many people acquire nationally certified qualifications. Around 9 per cent of US workers cite long-term workplace training as their main source of skills, with a further 27 per cent citing moderate workplace training.¹² This suggests that US skills might be substantially understated by the conventional data.

I.16 Despite debates over some of the international evidence, some clear messages emerge from the data about the strengths and weaknesses of the UK skills base:

- the number of people in the UK with high skills compares well with international levels (although the UK still trails the world-leader – the US);
- the level of intermediate skills in the UK is low, especially compared with Germany, other European countries, and, under some interpretations, the US;
- there are a large number of people in the UK workforce with low skills. UK performance in terms of basic skills is very poor, as highlighted by the Moser Report. The International Adult Literacy Survey, for instance, found that over 20 per cent of the adult UK population lack functional literacy.¹³ Only Ireland and Poland of the thirteen countries surveyed fared worse.

¹² US Department of Labor 2000.

¹³ Illiteracy is defined here by a variety of tests, including being unable to find a plumber in the Yellow Pages (Working Group on Literacy and Numeracy, 1999:2.3).

I.17 Evidence also shows that the UK has fewer workers with vocational qualifications than its European competitors, and often provides young people with a less diverse academic education than does the US. This potentially reduces the flexibility of the UK workforce and reduces adaptability to economic change. International evidence also suggests that income equality is correlated with the incidence of secondary and post-secondary vocational training in the population.¹⁴ The problems that the UK faces due to the existence of large numbers of workers with very low skill levels have been well documented by the Moser Report, by the National Skills Task Force and most recently by the PIU and the CBI-TUC.

THE IMPORTANCE OF INTERMEDIATE SKILLS

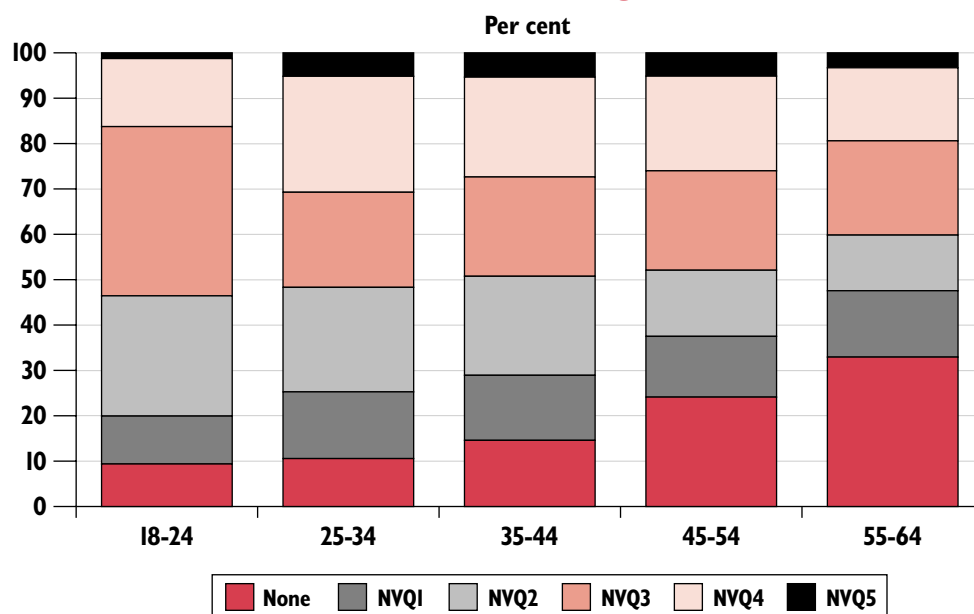
I.18 While other factors clearly influence productivity, this examination of the UK skills base supports the proposition that the UK's relatively low human capital stock plays a significant role in explaining relatively poor productivity performance.¹⁵ In particular, the UK needs to focus on reducing the proportion of workers with low skills and improving the supply of workers with intermediate level skills. The Government believes that there is a particularly strong case for increasing the number of adults with level 2 skills both because skills at that level are important in their own right but also because they provide a platform for adults to progress to higher skill levels. This means tackling the UK's basic skills problem and providing routes which allow people to progress to level 2 qualifications and beyond. Market failures are greater at level 2 (see Chapter 2) and adults who have attained level 2 are much more likely to either undertake training on their own initiative or receive training from their employers (see below) and thus gain higher-intermediate skills. Both the recent PIU report and the skills submission of the CBI-TUC to the Government's Productivity Initiative followed the National Skills Task Force in identifying this relative weakness in UK lower to intermediate skills levels when set against competitor countries.

I.19 In total, there are over 8 million people working in the UK with qualifications below level 2 (about a third of the workforce). 4.5 million of these people are employed in firms employing fewer than 50 people. Many of the problems in UK skills levels, especially those of low-skilled workers, can be attributed to historic failings in initial education, and especially in the schools system. There have been improvements in schools, and fewer young people have low skill levels than in older cohorts, but the proportion is still significant. Around 20 per cent of 18-24 year olds have qualifications below level 2, compared to around 29 per cent of those aged 35-44 and nearly 48 per cent of those aged 55-64. **Chart 1.5** shows the variation in qualifications between age cohorts, but also shows the persistence of a significant proportion of people with low skills, even in the younger cohorts. It is also concerning that the International Adult Literacy Survey found that the UK had higher levels of literacy inequality among young adults than other European countries or the US.

¹⁴ See Estevez-Abe, Iverson and Soskice 2001.

¹⁵ See also O'Mahoney 1999 and Layard, McIntosh and Vignoles 2001.

Chart I.5: Qualifications of different age cohorts



Source: Labour Force Survey Spring 2001.

I.20 Evidence from the labour market supports the conclusion that intermediate skills should be a key priority in the UK. Having a more highly skilled workforce allows firms, and the UK, to respond more quickly to economic change. For individuals, higher skill levels mean less time spent in unemployment, more adaptability to new opportunities and challenges, and higher wages. Having large numbers of people in the workforce with low skill levels limits the prospects of individuals and firms as well as negatively affecting national productivity and increasing wage inequality. It is estimated that the UK economy loses as much as £10 billion a year due to basic skills problems in the workforce.¹⁶

I.21 The CBI and the TUC note that 'projections for 2010 indicate that 35 per cent of jobs are likely to be in lower-skilled occupations but this trend has been accompanied by an increase in the need for such workers to have level 1 and especially level 2 skills (e.g. care workers)'.¹⁷ Furthermore DfES research has concluded that, the skills needed in jobs are constantly rising – 61 per cent of employers say the skills needed by their staff are increasing, and the proportion of jobs requiring at least level 2 qualifications on entry has increased from 54 per cent in 1986 to nearly 62 per cent in 2001.

I.22 Basic skills and level 2 qualifications are also often key to preventing social exclusion. For example, 34 per cent of young people with no qualifications, and 17 per cent of those with qualifications below level 2 are not in full time education, training or employment, compared with only 7 per cent of those with qualifications at level 2.¹⁸ Level 2 is increasingly seen as the baseline for successful participation in the labour market.

I.23 Survey evidence shows that the business world is increasingly recognising the importance of skills and training in raising productivity. A March 2001 MORI poll of nearly 200 UK board directors found that skills shortages had become the main concern of top company directors for the first time. 33 per cent of respondents cited skills shortages as the most important problem facing their company, up 21 per cent since 1999.¹⁹ Recent research for

¹⁶ Ernst and Young, cited in CBI-TUC Submission to the Productivity Initiative, p20.

¹⁷ CBI-TUC Submission to the Productivity Initiative, page 21.

¹⁸ Robinson 2001.

¹⁹ MORI 2001.

Investors in People UK supports this, finding that a lack of training was the single biggest barrier to productivity within organisations according to respondents (employers and employees), with 22 per cent citing it as the most significant barrier.²⁰ The recent skills report of the CBI-TUC to the Government's productivity initiative also underlines the importance of skills for productivity in the workplace and for the prospects of workers.

TRENDS IN UK SKILLS

I.24 The UK skills base is not static. The Government has pledged to increase spending on education by £10 billion in real terms between 2000-01 and 2003-04, which is a real terms increase of over 5.5 per cent each year for this period. The Government is also taking forward plans for radical reforms in schools, in order to ensure that young people have the skills they need to enter (and progress in) the workforce. These changes in policy are starting to have an impact on the skills of young people, and the Government is committed to continuing this improvement. New proposals announced in the Government's Green Paper on 14-19 education, *Extending Opportunities, Raising Standards*, will seek to reduce the barriers between academic and vocational study and provide a wider range of options to suit all young people.

I.25 There is also evidence that standards in schools are improving and having an impact on the skills of young people entering the workforce:

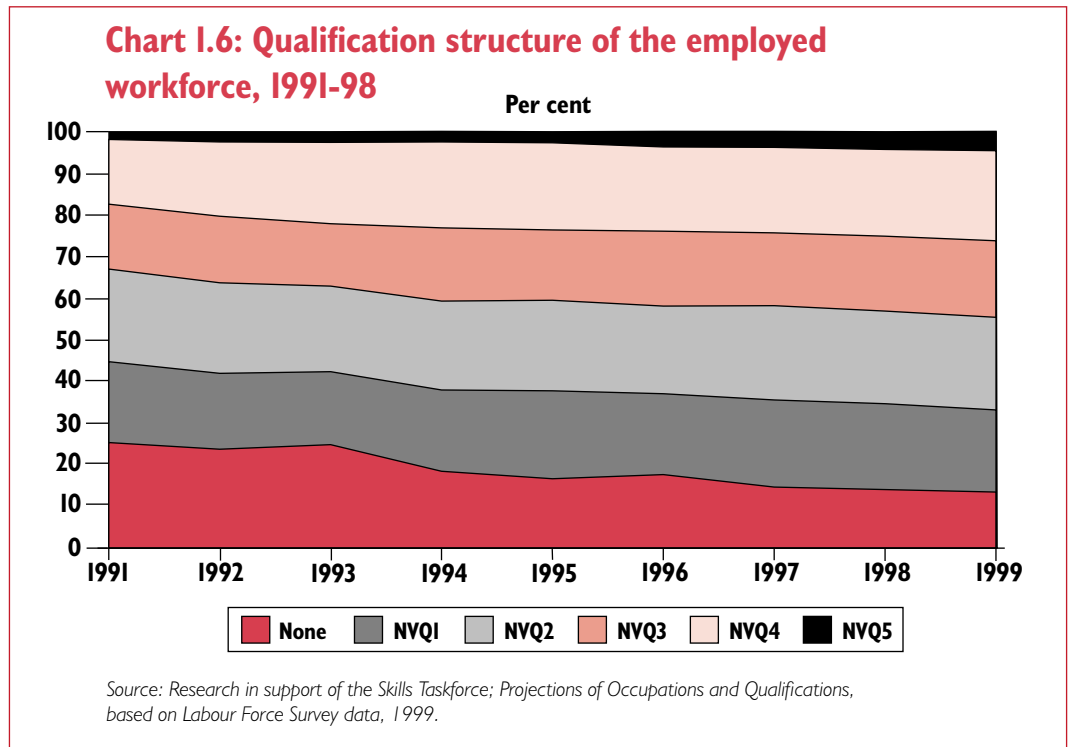
- literacy and numeracy levels at age 11 have increased consistently over recent years. Between 1997 and 2001, the percentage of 11 year olds achieving the levels expected for their age in English rose by almost 20 per cent, and in maths by almost 15 per cent;
- the proportion of 16 year olds obtaining at least five GCSEs at grades A*-C increased by nearly 8 per cent between 1997-98 and 2000-01, and reached 50 per cent in 2001; and
- the percentage of 19-year olds who have achieved at least level 2 has risen from 72.3 to 75.3 since 1997.

I.26 These changes and improvements in the education system are having a real impact on young people. However, these improvements only create a gradual change in the stock of skilled UK workers (**Chart 1.6** shows how slowly stocks have changed since 1997, despite new policy initiatives). Around 80 per cent of those in today's workforce will still be there in 2010, so 'demographic' trends cannot be relied upon to raise skill levels, and initiatives to increase life long learning are not having effects on the scale needed to close the skills gap. Data suggest that, on current trends, by 2010, 70 per cent of the UK workforce will hold at least a level 2 qualification.²¹ This compares with 73 per cent of the French workforce, and 83 per cent of the German workforce at the present time, and clearly shows that the skills gap will not be closed by current trends alone. It is also important to note that there is still a flow of low-skilled young people into the workforce, with 24 per cent of 19 year olds still lacking level 2 qualifications.

I.27 The Government will continue to strive towards ambitious targets to increase the achievement of young people throughout the education system. It is important to provide further options and support for those vulnerable young people who are most likely to leave full-time education with low skill levels. The Government will continue to support and develop vocational options for young people in education and training for young people in work.

²⁰ NOP World (for IiP UK) 2001.

²¹ Wilson, 2000



I.28 To widen the vocational choices available to young people and enhance skills levels among those entering the workforce, the Government is expanding the Modern Apprenticeships scheme, which provides work-based training for young people. In November 2001, the Government announced:

- a target for 2004 that 28 per cent of young people should enter an apprenticeship before they are 22;
- an entitlement, from 2004, to an apprenticeship place for all 16 and 17 year olds with 5 or more GCSEs at A*-G, including maths and English;
- a national framework for apprenticeships to ensure world-class standards, with high quality Apprenticeship Agents to help more employers deliver apprenticeships; and
- a major three-year, £16 million, marketing campaign aimed at promoting apprenticeships and increasing take-up among both young people and employers.

I.29 Improved achievement by young people will, in the long term, improve the skill levels of the UK workforce, but if the productivity gap is to be closed, there needs to be a step change in the skills of the existing workforce. The Government has already committed itself to achieving a target of reducing the number of adults in the UK without basic skills by 750,000 by 2004. The achievement of this target through a variety of basic skills initiatives (including free courses and nationwide publicity campaigns) will have a significant impact on the lives of those workers with the most limited skills. The CBI and the TUC have jointly acknowledged the importance of dealing with basic skills deficiencies in the workforce. The Government is considering in the run up to the 2002 Spending Review how best to continue helping those who lack basic skills.

I.30 New initiatives have started to increase life long learning. Individual Learning Accounts (ILAs) provided millions of UK adults with discounts and subsidies on training courses although, as a result of recent frauds, the Government regrettably had to suspend the scheme. The Government is, however, committed to introducing a replacement scheme, building on the strengths of ILAs and learning lessons from the first scheme. The University for Industry, operating under the Learndirect brand name, has rapidly established itself as a route to training for many adults (with take-up of over 650,000 courses by January 2002). Learndirect is now also developing promising new 'sector hubs' which relate training to employers in specific occupational sectors. This development is an important complement to the work which will be done by new Sector Skills Councils (SSCs) being put in place to replace National Training Organisations: these new bodies will be critical partners to Government in determining the skills implication of its policies. The development of trained Union Learning Representatives is also allowing firms and employees to communicate more effectively and ensure that training suits the needs of all concerned.

WORKFORCE TRAINING IN THE UK

I.31 To achieve improvements in UK skill levels it is necessary to further improve both initial and continuing training – and in the latter case, particularly the development of those already in work (workforce training). A range of research has confirmed the link between workforce training and productivity.

I.32 The UK performs relatively well in some international comparisons of participation in workforce training. The Eurostat database ranks the UK fifth of seventeen in terms of participation. Similarly, the National Skills Taskforce cites the Continuing Vocational Training Survey, which puts the UK third, behind only Denmark and Germany, and well above the mean of European Union countries.

I.33 However, these comparisons give a somewhat false picture, which the National Skills Task Force (2000) and the wider literature acknowledge:

- first, they deal with levels of provision (i.e. proportion of employers providing training or employees receiving it), rather than volume (i.e. number of hours training per worker) of training. It is not necessarily the case that higher participation of firms in training mean more volume or, indeed, a greater addition to the stock of human capital. UK workers tend to receive shorter training courses than many of their European counterparts which means that in terms of volume of training the UK ranks less highly than on the participation measures;
- secondly, the specification of 'training' is not clearly comparable across countries. In the UK, for instance, health and safety and induction training are often included, when such training actually has very little impact on skill levels.²² In other countries (e.g. Germany) the data usually exclude initial training based on apprenticeships or similar arrangements – which can form the core of these nations' workplace training. These difficulties are particularly significant given the evidence suggesting that the type of training, perhaps more than the volume, is a key determinant of its contribution to increases in skill levels and productivity;²³ and

²² The Learning and Training at Work Survey 2000 shows that 70 per cent of on-the-job training in the UK was health and safety related while 50 per cent was induction related. These categories are not mutually exclusive.

²³ Barrett and O'Connell 1998.

- thirdly, data on flows of training for different countries need to be related to their stocks of skilled workers. Two countries with similar flows of skilled labour entering the workforce, for instance, will maintain rather than close skills gaps between them. The fact that the UK has a much larger stock of low-skilled workers than most of its competitors means that training levels must be significantly higher in the UK if the skills gap is to be closed. It is also important to bear in mind that many European countries have traditionally emphasised initial training for young people to a greater extent than the UK has, which reduces the need for adult training in these countries to some degree.

Distribution of training

I.34 International evidence on training also disguises significant inequity in the distribution of training. Opportunities for training in the UK, as often elsewhere, are unevenly distributed.²⁴

I.35 In particular, more highly qualified people are more likely to receive training than their lower-skilled counterparts. According to National Skills Taskforce (NSTF) figures, 19 per cent of employees qualified at Level 4 (degree level and above) had received training in the last four weeks, as opposed to 8 per cent of those qualified below Level 2. The close connection with existing skill levels suggests that the pattern of workforce training in the UK reinforces, rather than remedies, the past failings of the education system. There are also strong links between income and training opportunities, suggesting that current training patterns tend to widen income inequality. The uneven distribution of training is a problem faced by many countries, but it is a particular problem for the UK because the group of lower-skilled workers who receive little training is much larger.

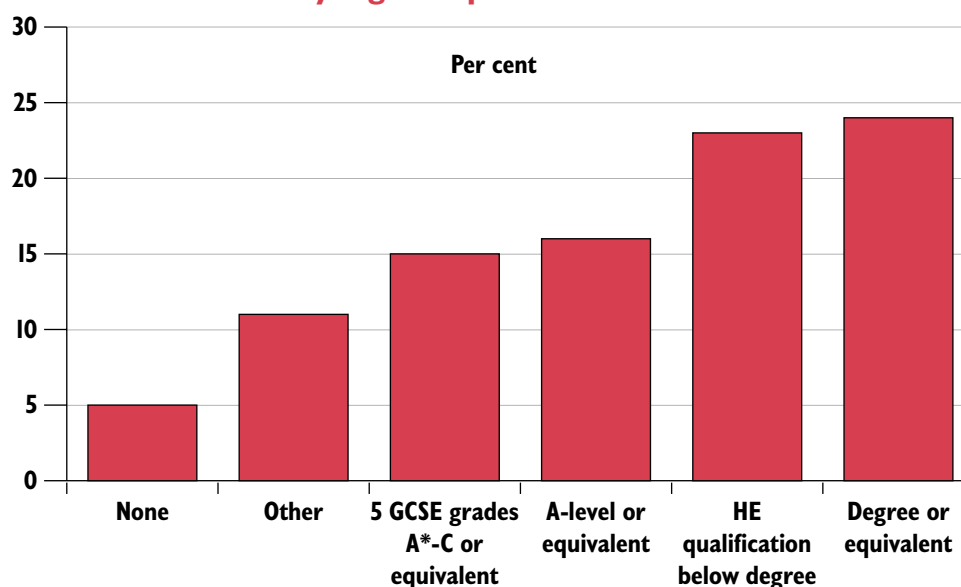
I.36 There is a particularly notable gap between the amount of training received by those with level 2 qualifications and those with qualifications lower than this. By comparison, the training received by those at level 2 and 3 is relatively similar (see **Chart 1.7**). Once workers achieve basic skills and level 2 qualifications they are more likely to receive training from their employers. This reinforces the point that basic skills and level 2 skills are key for further progression. Supporting people in the workforce to achieve basic skills and level 2 can thus significantly improve their prospects in the longer term.

I.37 Another key distributional point is that people who work for small firms are much less likely to receive training than those who work for large firms. 92 per cent of firms with more than 200 employees provide some off-the-job training; only 36 per cent of those employing less than 25 do. Since most working people with low skills (53 per cent) work for firms employing less than 50 staff, this is a matter of particular concern.

I.38 The variation in the volume of training received by different groups is matched by a variation in type. Low-skilled people are less likely to receive general, transferable skills than their more highly skilled colleagues. This leaves them with less flexibility and lower returns to training.

²⁴ See, for example, Sohlman 1999.

Chart I.7: Percentage of employees receiving training in the last four weeks by highest qualification



Source: Labour Force Survey, Autumn 2000.

CONCLUSIONS

I.39 The UK has a high proportion of low-skilled workers compared to key European competitors, and, under some interpretations, also compared to the US. The UK has a correspondingly lower proportion of workers with intermediate skills. The UK productivity gap is partly explained by this relative weakness in the UK skills base.

I.40 Although there have been some improvements in school education and thus in the skills of people entering the workforce, the 'stock' of workers with very low skills is being reduced only very slowly. It is this stock which determines productivity. The distribution of training in favour of those who already have high skill levels reinforces the problem. If the skills gap is to be closed, and productivity increased, then action is needed to make sure that more low-skilled workers in the UK receive training. The pilot schemes set out in this document will explore how Government, employers and individuals can best work together to achieve change in this area.

IDENTIFYING MARKET FAILURES

2.1 The Government's approach to improving UK productivity performance is based around identifying and then tackling barriers that prevent markets from functioning efficiently. Economic theory suggests that market failures exist when the private returns which an individual or firm receives from carrying out a particular action diverge from the returns to society as a whole, resulting in an outcome which is not efficient from the point of view of the whole economy.²⁵

2.2 Given that benefits accrue to both employers and individuals from training, both groups should invest in training up to the point at which marginal returns are matched by marginal costs. However, willingness to pay for training is limited not only by rates of return. Market failures reduce investment in skills, relative to both the private rate of return for the employer/employee and/or to the social rate of return.

2.3 The market failures which affect training and skills can be broken down into two categories:

- general market failures which affect levels of investment in training regardless of the level of human capital in the economy, including failures in the labour and credit markets, information failures and social externalities; and
- a more specific set of market failures relating to the interaction between supply and demand for skills at certain skill levels, which can cause economies to be trapped in a 'low skill equilibrium'.

General market failures

2.4 Employers may under-invest in training of their employees because of **externalities**.²⁶ These occur because firms that invest in training may not be able to capture all the benefits of that investment. Firms worry that once trained, the employee will leave the firm before the firm has recouped its investment (the 'poaching problem'). 'Poaching' firms receive a benefit in the form of a more productive worker, and workers gain through higher wages. However, the training firm may lose out.

2.5 Unless training 'pays off' very quickly or is not very transferable, firms may therefore be reluctant to provide training to their workers.²⁷ Small firms are more likely to fear poaching because they have smaller internal labour markets and therefore fewer opportunities for individual progression, making it harder for them to retain staff in the longer run. Employers may also be particularly unwilling to provide training for low-skilled individuals as they are often in less permanent jobs in sectors with high staff turnover.

²⁵ Market failures can occur in many different ways and for a wide variety of reasons. Market failures can be classed into four main categories however: externalities (when the actions of an actor create benefits or costs not borne by that individual), market power distortions (where competition is imperfect and firms do not have incentives to produce efficiently and set low prices), incomplete information (which means that actors cannot make fully informed economic choices) and poor regulation (where government regulation impedes the operation of efficient markets).

²⁶ These are spill-over effects, which occur when actions by a firm or individual create benefits (or costs) that do not accrue (or are not borne by) that firm or individual.

²⁷ Cassen and Mavrotas 1997.

2.6 Firms can partially offset reductions in productivity during training and the expected lower returns caused by poaching and other labour market failures by paying lower wages to workers undertaking training. However, **information problems** increase the likelihood that employees may not be able to judge the quality of their training or appreciate the benefits, therefore reducing their willingness to accept lower wages during the training period or to receive any training at all.²⁸ This is supported by the fact that motivation to train is higher among those with more training, who have more information due to previous experiences of training. Low-skilled individuals are, therefore, less likely to demand training than their high-skilled colleagues. The National Skills Task Force reported that one of the main reasons that adults in the UK, who had not trained recently, gave for not undertaking training was 'I prefer to do other things'. Other, similar, reasons were 'I'm not interested in learning' and 'I don't need to learn for my job'. This suggests that people may not be fully aware of the potential benefits of training.²⁹ The recent report of the PIU also emphasised the importance of information to encourage and promote training in the UK.

2.7 Insufficient information is also likely to cause firms to provide less training if they are uncertain about the benefits of employee training in terms of increased productivity. This uncertainty may be exacerbated by problems such as poor access to markets or poor management. As a result of the difficulties firms have in assessing the potential improvements in productivity arising from training, they are more likely to offer training to those employees who have already demonstrated that they can achieve qualifications, with the result that those workers with the fewest qualifications receive the least training.

2.8 **Credit market imperfections** can also constrain training. Training is costly, but individuals expect to obtain higher wages from increased training. Some individuals may wish to borrow to fund training in the expectation that they will be able to pay back the loan through higher future wages. However, low-paid employees in particular are likely to be credit-constrained and unable to obtain loans to pay for training. Given difficulties in quantifying and guaranteeing future streams of wages, it is difficult to use future income increases as security. Employers, particularly in small organisations may also face credit constraints and cash flow problems which inhibit their willingness to contribute even to that training which they are prepared to fund in the light of labour market and information imperfections.

2.9 The generic market failures outlined above mean that the level of training provided by the market is likely to be inefficiently low from society's point of view. In addition, if the private returns to training are lower than those to society as a whole (due to externalities such as lower unemployment or better health) then training will be underprovided even if the 'private' market is perfect. Training up to level 2 has potentially large social returns. For example, individuals in the UK with level 2 qualifications are only half as likely to be unemployed as those with no qualifications.³⁰

2.10 Supporting training for low-skilled adults is an important way of reducing social exclusion as well as promoting productivity. Social inclusion is about quality of work and prospects for the future as well as employment. Those with basic skills problems, or skill levels below level 2, usually receive low wages and have little prospect of achieving progression to higher incomes and more rewarding work. They also, as mentioned above, face higher risks of unemployment. Training people to level 2 can thus have large impacts on the life chances of individuals. There is also strong evidence to suggest that training for low-skilled people has broader social returns in terms of reduced crime and better health. These social returns further strengthen the rationale for government intervention.

²⁸ Stevens 1999.

²⁹ The National Skills Task Force 2000: p28

³⁰ Labour Force Survey data 2001.

Low skill equilibrium

2.11 The recent work by the PIU highlighted particular problems associated with 'low skill equilibrium': 'a self reinforcing network of societal and state institutions which interact to stifle the demand for improvement in skill levels....[resulting in] the majority of enterprises staffed by poorly trained managers and workers produc[ing] low quality goods and services'.

2.12 If employers believe that there is a low supply of skilled workers, they are likely to adopt production techniques that require less skilled workers.³¹ This in turn boosts demand for low- rather than high-skilled workers, weakening the incentive for workers to train, reinforcing employer perceptions, and so on.³² Finegold and Soskice showed that managers' decisions to adopt a low-skill form of work organisation, even if it hurt the performance of the economy, could be a rational response to the institutional conditions in which they operated. Although this kind of vicious circle may not apply in all sectors of the UK economy, it certainly does in some, and there is enough evidence of such problems for them to be a cause for concern.

2.13 An economy might be able to move to a new equilibrium by successfully altering the incentives facing firms and individuals, which would enable some market failure problems to be overcome. If, for example, the Government, employers and individuals invested in training and this had a significant impact on the skills base, then firms could begin to adopt more skill intensive (and more productive) strategies, individuals would have greater incentives to invest time and resources in training, and there could be a once and for all change in the training market.

2.14 A similar case has been made by economists looking at complementarities between skills levels and other aspects of industrial performance. Layard, McIntosh and Vignoles (2001) suggest that the low level of skills in the UK is one reason why Britain attracts less physical capital investment than would otherwise occur. Low levels of skills make firms less likely to invest, especially in new technology; poor capital stock, in turn, makes firms more likely to adopt low-skilled production techniques.

The implications for Government intervention

2.15 The existence of these market failures, and their potentially damaging consequences, imply a case for Government intervention to raise levels of training in order to:

- address generic market failures which may inhibit workforce training; and
- help the economy move from a lower to a higher skills and productivity equilibrium.

2.16 However, in order for intervention to be effective, the Government needs to have a clear idea of how it will correct these market failures, bearing in mind problems such as imperfect information, conflicting incentives and the need for transparency. In particular, the Government's approach to supporting and providing training needs to be carefully designed so that the appropriate incentives, rights and responsibilities are provided for everyone involved. Such an approach will help stimulate demand from employers and individuals to ensure that investment in training leads to improvements in performance.

³¹ CBI-TUC Submission to the Productivity Initiative 2001, p10.

³² See Finegold and Soskice 1988.

GOVERNMENT POLICY

2.17 As outlined in Chapter 1, the Government is taking action to improve the skills of young people and adults in a variety of ways. The Government is committed to continuing support for improved standards in the school system, as well as reforms to ensure that all young people have the opportunity to gain skills which are relevant in the labour market and appropriate to them. The Government has introduced measures which are starting to have an impact on adult skills, but is committed to further radical thinking in this area, to ensure that real results are achieved. New institutional arrangements are allowing more strategic thinking about workforce development in the UK. The Learning and Skills Council (LSC) in England now oversees all post-16 education, and is able to plan strategically both nationally and locally. New Sector Skills Councils (SSCs) will provide the LSC, and equivalent bodies in other parts of the UK, with key intelligence about sector skills priorities and how these can be addressed effectively by training providers working closely with employers (see Box 2.1). The Department for Education and Skills (DfES), other government departments and the LSC are developing a range of policies to support adult skill development in different ways.

2.18 The recent PIU report set out a framework for policies to improve UK workforce development. The Government welcomed this report, and recognises the need to do more to support and encourage people in Britain to participate in education and training, especially those who have no or low levels of qualifications and skills and who need to gain skills and qualifications up to level 2.

Box 2.1: Sector Skills Councils

Employers have a new opportunity to drive up skills and productivity and tackle related problems through UK-wide sector Skills Councils (SSCs). SSCs will be employer-led, working with trade unions and professional bodies, to better focus skills development on the current and development needs of their industries and public service sectors.

SSCs will be strategic bodies with the sole purpose of identifying the skills and productivity needs of their sectors and galvanizing action to tackle priority issues. They will support the effective operation of sector labour markets by ensuring occupational standards, learning provision and qualifications meet sector needs. SSCs will work in partnership with government, economic development agencies, and education and training bodies to improve the delivery of skills policy and learning provision.

Where employers want to form a SSC, can provide the necessary influential leadership and meet the minimum operating standard, the Government will provide public support through the new Sector Skills Development Agency (SSDA) and ongoing funding to cover the core costs of operation. In return for this public commitment and investment the Government expects to see significant improvements in sector skills and productivity performance and employer investment in workforce development.

SSCs will be licensed by the Secretary of State for Education and Employment, in consultation with Ministers in the devolved administrations, for periods of five years. A small number of Trailblazer SSCs are currently being licensed for an initial two-year period.

Tackling Basic Skills Problems

2.19 The Government views dealing with basic skills problems among adults as a key priority. A basic skills strategy has already been put in place by the Government to help those with the lowest levels of skills. Sir Claus Moser's 1999 report 'A Fresh Start' highlighted the UK's basic skills deficiencies. This estimated that up to 7 million adults (1 in 5) in England have literacy skills at or below those expected of an average 11 year old and that even more (1 in 4) have a problem with numeracy. To tackle this problem the Government has introduced successful strategies to improve literacy and numeracy results in primary schools and also launched *Skills for Life* – a national strategy for improving adult literacy and numeracy – in March 2001 (see **Box 2.2**). The Government is considering the next steps in taking this strategy forward in the run up to the 2002 Spending Review.

2.20 Basic skills are the first rung on a 'learning ladder'. Basic skills must be seen as the first step towards acquiring more advanced skills if UK productivity is to be significantly improved. The Government is committed to supporting the progression to level 2 of those individuals who are benefiting from *Skills for Life*. This requires further intervention to stimulate demand for learning by reducing the credit, information and incentive barriers which underpin generic market failures, and by providing a 'push' to move the economy to a higher skills equilibrium. Intervention should be targeted at those with low skill levels as they are most likely to be affected by market failures, as outlined above.

Box 2.2: Skills for Life

Skills for Life sets out the Government's approach to increasing demand, improving supply and raising standards in basic skills training, targeting those priority groups where literacy and numeracy difficulties are known to be common and where the Government's help can have the greatest impact. These priority groups include unemployed people, prisoners and those supervised in the community, the homeless and those who do not speak English as their first language, as well as workers in low-skilled jobs.

The Government's strategy provides the blueprint for reaching the target set in the 2000 Spending Review of helping 750,000 adults improve their skills by 2004. The Adult Basic Skills Strategy Unit has taken forward work to raise awareness and increase demand, most notably via the national 'Get On' promotion campaign launched on 30 August 2001. It has also made a new learning infrastructure available nationally after successful evaluation in nine pathfinder areas, and over 7,000 teachers have been trained in the new learning infrastructure.

In the short time that it has been in place the Government's strategy has proved successful, with at least 91,000 learners having achieved improved literacy and numeracy skills by the end of October 2001. However, the Government recognises that it will need to continue to work hard to raise the level of the UK's basic skills to that of competitor countries, and is considering how best to take the strategy forward in the context of the 2002 Spending Review.

International Policy Approaches to Workforce Training

2.21 Over the last fifty years, a variety of approaches have been used in the UK and in other countries to try to encourage employers and individuals to undertake more training. Policies have ranged from purely voluntary frameworks to statutory based systems with significant state involvement. There is also a key distinction to be made between systems which are heavily focused on youth schemes and those which emphasise lifelong learning. It is useful to consider the successes and shortcomings of various different approaches in both the UK and other countries in order to place the current policy debate in context.

2.22 Countries such as Germany have had success at providing a high proportion of the workforce with intermediate skills through long-standing vocational programmes for young people. Germany has a 'dual training' apprenticeship system, started by over half a million young people every year. Under this system, young workers receive 1½ days per week of class-based training in a vocational college paid for by the state, alongside practical training with an employer for the remaining 3½ days. The skills base provided by the apprenticeship system has reduced the need in Germany to focus on workforce development.

2.23 The German system is also largely based on statutory rather than voluntary principles – firms must belong to the chambers of commerce which coordinate the apprenticeship system, and young people are effectively obliged to remain in training when they leave school. Such a rigid framework is now being challenged. It is now recognised by many that life long learning must become a higher priority in Germany if the workforce is to become adaptable to new technology and other changes in working practices. There are difficulties in engaging sufficient employers in training, leading to calls for a more flexible training policy framework in Germany, which may eventually lead to an alternative approach with greater emphasis on life long learning.

2.24 The US provides an interesting counter-example to Germany. Policy makers considering adult training in the US face a very different educational context to their German counterparts. Education in the US has traditionally been general, and concern has often been expressed about the quality of high school education in terms of preparing young people for the workforce. The US has, at least partially in response to this, developed a system focused on flexible adult learning. Adults often gain skills over long periods, taking modular courses at local colleges, gradually gaining qualifications. The US system is based almost entirely on voluntary principles. While this has allowed the US to develop a system which is fairly responsive to employer need and which encourages life long learning, it has also led to a lower proportion of adults gaining intermediate vocational skills compared with countries such as Germany.

2.25 In order to stimulate demand for training in the US, policies have been introduced that provide subsidies for firms that train workers. Schemes vary across the country, but all are voluntary and are supported only by limited federal funding: in constant dollars, federal funding for training declined by 8 per cent between 1983 and 1998, while the size of the workforce increased by almost 30 per cent. As a result, coverage of such schemes is relatively low. Major recent initiatives have been based on the Workforce Investment Act, passed in 1998. The Act provided various approaches for states and local areas to take to improve their workforce development systems, but take up has been low and the initiatives have had only limited success. The measures introduced in the Workforce Investment Act also failed specifically to target the low-skilled people who face the greatest barriers to training. Funding for Workforce Investment measures has now been greatly cut, and US training policy is now almost exclusively state/locally focused.

2.26 France and Australia have both used levies in attempts to increase training. In both cases the levies require firms to pay a certain percentage of their payroll costs towards providing training for their staff. In France, a training levy has been running since the early 1970s. It requires firms with more than 10 employees to pay 1.5 per cent of payroll costs towards training activities.³³ The levy has been successful in raising expenditure on workforce training over the last 20 years. However, the regulation has created an expensive system with limited beneficiaries. More highly trained, mobile workers have benefited, while less skilled employees remain far less likely to receive training.³⁴ Furthermore, small firms remain less likely to train; there is evidence that they see the legal obligation essentially as a tax.³⁵

2.27 Similar problems were found with the training levy in Australia. This ran from 1990 to 1994 and required firms with payrolls in excess of \$200,000 to spend 1 per cent³⁶ of that on employee training. The policy has been comprehensively evaluated and, like the French system, it succeeded in raising the amount of training that firms undertook at the aggregate level³⁷. However, it had no real impact in sectors that trained poorly before the introduction of the policy. The levy also failed to improve the distribution of training in favour of those with low skills.

2.28 Training policy in the UK has moved between statutory and voluntary approaches. The UK imposed highly interventionist statutory measures in the 1960s. The Industrial Training Boards (ITB) required firms to pay training levies which were then used to fund training.

2.29 The statutory elements of ITB approach were not wholly successful. ITBs failed to address the market failures that affect training at the root and often imposed high costs on employers who did not wish to participate, without achieving significant results in terms of skills and training. The Government does, however, remain committed to supporting statutory training frameworks for those industries where employers and employees favour this model, and is also continuing to support a sectoral approach to skills through new Sector Skills Councils (see Box 2.1 above).

2.30 Since the ITBs were largely removed in the 1980s the UK has taken an almost entirely voluntarist approach to workforce training.³⁸ The Investors in People standard, for example, is a means of encouraging organisations to integrate their plans for workforce development with their overall business plans. Recent initiatives in the UK such as Learndirect have succeeded in raising the amount of training in the UK economy in certain areas such as information technology, but more is needed. The market failures that limit training in the UK have not been overcome, as demonstrated above. There is also serious cause for concern about the fact that UK training policies have tended to be particularly ineffective at reaching those with the lowest levels of skills, who most need training.

New Approaches for the UK

2.31 It is clear that in the UK the strongly compulsory approach of the ITB administered levies was not effective at creating a step change in training. It is also clear, as the Chancellor of the Exchequer highlighted in his Pre-Budget Report speech in November 2001,³⁹ that the more recent, purely voluntary approach has not brought about the step change in UK skill levels that is needed to close the productivity gap.

³³ For details on the French levy see Greenhalgh 1999.

³⁴ C. Greenhalgh, Does an employer training levy work? – the incidence of and returns to adult vocational training in France and England 2001.

³⁵ Bertin et al. 1991.

³⁶ The levy was increased to 1.5 per cent in 1992.

³⁷ Fraser 1996.

³⁸ A small number of training boards remain. For example the Construction Industry Training Board (CITB). It is funded through a levy from employers in the industry that raises around £80 million annually.

³⁹ Full text of the speech can be found at: http://www.hm-treasury.gov.uk/Pre_Budget_Report.

2.32 What is needed in the UK, therefore, is a new approach that encourages firms and individuals to train, through targeted incentives from the Government, but which also requires them to recognise and meet their roles and responsibilities. The skills report of the CBI-TUC to the Government's Productivity Initiative recognised that such a joint approach by all stakeholders is needed to change the culture of workforce training in the UK and to create a step-change in the amount of training undertaken.

CONCLUSIONS

2.33 The economy will not maximise long term growth potential, and UK society cannot be inclusive, if over a third of the workforce have few or no skills and qualifications. These problems will not be resolved solely by better educated young people replacing less well-educated people retiring from the workforce, except in the very long term. More must be done to increase the skill levels of those already in the labour market; over 80 per cent of those currently in the workforce will still be there in 2010.

2.34 A strategy to help those in the UK without basic literacy and numeracy skills has already been put in place, and the Government will continue to support this policy. It is important now to build on basic skills initiatives and help people to progress to higher skill levels. The next chapter sets out details of new Employer Training Pilots which will explore new ways to help low skilled workers move on from basic skills to achieve level 2 qualifications and further progression. Those who need to attain basic skills to move towards a level 2 qualification will also be supported and encouraged to do so in the pilot schemes.

2.35 Changes in Government policy must be accompanied by changes in attitudes and in work culture. As noted in Budget 2001, Government action alone cannot bring about the sort of changes necessary to make a real impact on the problems of low skills. It is important that everyone – employers, individuals and government – takes seriously their responsibility to deliver a high skill, high productivity economy. The CBI and the TUC have emphasised that 'training and development is a shared responsibility'.⁴⁰ Government must play its part to deal with market failures, and support individuals and employers in their efforts to increase skill levels. Employers must take responsibility for the training and development of all their staff to ensure that business needs are met, and consider the career development of employees. Individuals must take responsibility for their personal career development, and be prepared to learn new skills.

⁴⁰ CBI-TUC Submission to the Productivity Initiative, page 23.

INTRODUCTION

3.1 As shown in earlier chapters, the UK has a significant skills gap with its main competitors at the lower to intermediate level. This limits productivity and hampers efforts to reduce social exclusion. To improve the stock of skills in the workforce, especially at the lower end, it is necessary for people already in the workforce to be trained. New approaches to workforce development are especially important for those with low skills, and for those working in small firms, who tend to receive less training than other groups.

3.2 In Budget 2001, the Government committed itself to considering ways in which it could use the tax system or other mechanisms to encourage increased training in the UK. The Government remains committed to its goal of improving skills in the UK, and would be willing to use the tax system to further support training if this would be the most effective way of reaching those who most need support. The Government also believes that fiscal measures alone will not be enough to create a step-change, and that an integrated package of measures will be required.

3.3 In the 2001 Pre-Budget Report the Government announced a series of pilot schemes to test a new policy model to support training for low-skilled people in the workforce. This chapter sets out more details of these pilot schemes and the policy approach which they will test. This approach matches free courses for employees who are training to gain basic skills or level 2 qualifications, with paid time off work for these employees to train and financial support to their employers alongside information and support measures for individuals, employers and training providers. The Government hopes that this approach will reach those employers and individuals who do not currently engage in training. Reducing the numbers of people without basic skills is the Government's priority, but as previous chapters have shown, progression to level 2 and beyond is essential for productivity and social inclusion as an increasing number of jobs require skills at least at this level.

A SKILLS AMBITION FOR THE UK

3.4 Since 1997, through the various New Deal initiatives, the Government has focused on getting people back into work, with over a million people entering employment since 1997. As the Government continues to expand opportunities to enter employment and extends employment initiatives to new groups, a key priority is to ensure that those in work have the skills they need to adjust to economic change, be successful in their careers, and achieve their potential. There is a particular need, as outlined above, to support those who need to acquire basic skills and those who need to progress to level 2.

3.5 Likewise, Government policies to promote enterprise and innovation rely on employers being able to draw on and invest in a more flexible, highly skilled workforce. Requirements are particularly acute in sectors or regions undergoing rapid economic change. Incentives for employers to invest further in the workforce will be increased as they see the benefits to them and can combine skill development with other measures to take their business forward.

3.6 As outlined in Chapter 2, the Government has already started to tackle the UK's skills problems. Increased support for education and reforms to the school system are having an impact on the skills of young people. Initiatives such as Learndirect and the New Deal are helping adults who wish to improve their skills, supported by clearer and more effective

institutions such as the LSC and new SSCs. The Government has emphasised the importance of helping those who have basic skills problems in particular. The *Skills for Life* initiative is making an impact on the lives of people with basic skills difficulties, but more must be done on this problem and to provide better routes for progression from basic skills to level 2.

3.7 As announced in the 2001 Pre-Budget Report, the Government will, in the forthcoming Spending Review, consider what targets should be set for the future, to reduce by 2010 the numbers of adults in the workforce both without basic skills and who have not achieved level 2. These targets will be delivered both through increasing the demand for training among individuals lacking basic skills and level 2 qualifications, especially those in work, and improving the quality and efficiency of supply (the proportion of demand that is converted into skills and qualifications). Progress towards such targets will complement and enhance the Government's ambition to reduce the numbers of people in the UK who lack basic skills by 750,000 by 2004, and support progression for people gaining basic skills with the help of existing initiatives.

3.8 In order to realise this ambition, it will be necessary to increase the demand for training. The policy approach explored in this chapter places demand at the centre. The recent PIU report explored the problems of the demand for training in some depth and the CBI-TUC productivity working group noted that 'the importance of increasing demand [for training] cannot be overstated'.⁴¹ It is of course also necessary to ensure that supply is efficient and tailored to the needs of learners. Chapter 4 examines some of the issues related to the supply of training.

A NEW APPROACH TO UK SKILLS POLICY

3.9 The Government shares the vision set out by the PIU in their November 2001 report that: 'In 2010, the UK will be a society where Government, employers and individuals actively engage in skills development to deliver sustainable economic success for all'. The UK needs to achieve such a step change in workforce training if it is to achieve the improvements in skills required to help close the productivity gap. The Government is committed to encouraging a culture of work where training is available to all who need it, and where workforce development is a priority for all firms.

3.10 The current voluntarist training system has increased the volumes of training undertaken by workers in the UK, but it is clear that, on the basis of current measures alone, the UK is unlikely to attain the levels of human capital which could provide the basis for the productivity growth needed to close the productivity gap. This is an issue of training type and quality as well as of volume. There is much work to be done to ensure that the UK training system does not continue merely to reinforce the past failings of the education system by only offering training to those with relatively high levels of qualifications.

3.11 As outlined in the 2001 Pre-Budget Report, one policy approach now being considered by the Government, and being tested by the new pilot schemes, would build on existing basic skills policy, life-long learning initiatives, and the commitment shown to improving education since 1997. The approach to be tested consists of four complementary, linked elements:

- (i) free learning provision and accreditation for employees without basic skills or level 2 qualifications, to work towards recognised qualifications up to the level 2 standard (including basic skills), with approved providers. This would build on the current provision of free courses for basic skills under the Government's *Skills for Life* initiative;

⁴¹ CBI-TUC Submission to the Productivity Initiative, page 20.

- (ii) some form of arrangement for individuals to take up training – such as a minimum entitlement for all employees who have not attained basic skills or level 2 qualifications to paid time off each year to train towards the level 2 standard. The Government will explore different possible time periods in the pilots;
- (iii) financial support for employers whose staff take time off to train to acquire basic literacy, numeracy and ICT skills and to progress to level 2, with additional financial incentives for small firms. This financial support could be delivered through a tax credit or other mechanism. The Government will consult on these options, which will be developed jointly with DfES and alongside the wider work of the PIU, and will explore different levels of compensation in the pilots; and
- (iv) extended information, guidance and support for employers and individuals taking part in, or considering taking part in, any new system. Among other possibilities, these could include the wider deployment of ‘Skills Champions’ along the lines of Union Learning Representatives, which have proved successful in breaking down individual and employer barriers to skill development. This approach is being tested in a DfES Small Firms Development Account pilot in Leicestershire.

3.12 The Government believes that no single one of these four elements would be able to deliver a step change in UK skills. All four elements are interlinked. As the PIU concluded, there are many factors which limit the amount of training undertaken by workers in the UK, and different policy responses are required to deal with different barriers to training.

3.13 Pilot schemes to test this proposed policy approach will be operational by September. The pilots will be used to explore the details and impacts of this policy approach on employers and individuals and to gather evidence on them. There will also be opportunities for other stakeholders to comment on the effectiveness of the arrangements. The Local Learning and Skills Councils (LLSCs) who will be running the pilot schemes have developed their plans in conjunction with local stakeholder groups including employer organisations and unions.

3.14 Employer Training Pilots will operate in 6 areas of England;⁴² details are set out in **Box 3.1** below. They will be run by the LLSCs in Birmingham and Solihull, Derbyshire, Essex, Greater Manchester, Tyne and Wear, and Wiltshire and Swindon and will be managed centrally by the LSC and DfES. LLSCs will operate pilots within a defined national framework, but will be responsive to local circumstances and deploy existing initiatives where these can clearly be used to support the framework. The details of individual pilot schemes, including the precise levels of time off and compensation in each area, will be decided in consultation with the LLSCs and announced in the coming weeks.

3.15 All pilot schemes will offer free basic skills and level 2 courses to low-skilled employees from participating firms, and will provide information, advice and guidance to both individuals and their employers. Three of the pilot schemes will require that all low-skilled employees in participating firms are offered 35 hours of paid leave each year to train; the other three pilot schemes will require an offer of 70 hours.

⁴² Education and training are devolved matters, so the pilot schemes will be run in England only, but the devolved authorities have received consequential monies with respect to the additional finance for the pilots announced in the Pre-Budget Report. The Welsh Assembly Government set out plans in its Skills and Employment Action Plan to run similar pilot schemes in Wales from this Autumn, exploring the impact of providing free learning up to level 3 for adults.

Box 3.1: Employer Training Pilots

Birmingham and Solihull includes some of the most deprived communities in the UK, and also has high employment in certain sectors which have unmet needs for staff with basic skills and level 2 skills. The Birmingham and Solihull LLSC will work in partnership with FE colleges, private training providers, trade unions, employer organisations and Business Link advisers to involve employers in the pilot scheme and develop effective supporting structures.

Derbyshire has a higher than average proportion of economically active people with low or no qualifications. Training in certain local areas falls well below average, and a local survey revealed that only half of those involved in workplace learning were studying for a qualification. The Derbyshire LLSC will target employers not currently engaged with education and training to ensure that the pilot can draw conclusions about those firms which are hardest to reach.

Essex has low levels of adult skills compared to the national average and 35 wards with particularly high levels of deprivation. The county is also currently the site for major regeneration projects which are generating new jobs, many of which require at least level 2 skills. The Essex LLSC will work with a range of local partners as well as the East of England Development Agency to develop a pilot scheme which reflects distinctive local skills needs as well as testing national variables.

Greater Manchester faces skills shortages in key areas such as customer handling and team working. The Greater Manchester LLSC will build on its existing knowledge of the barriers which prevent local individuals and employers from participating in learning, and of existing and future skills needs to focus on ways in which employers and individuals can be successfully engaged in the pilot.

Tyne and Wear's working age population has a higher incidence of basic skills problems than the national average, and specific wards present particular cause for concern. The Tyne and Wear LLSC will build on well-developed information, advice and guidance networks to reach out to employers, especially SMEs. The LLSC will also work with training providers who are already customising their activities to meet the needs of local employers.

Wiltshire and Swindon have very low levels of unemployment and some of the most severe skills shortages reported in the UK. The LLSC and its partners have experience in delivering similar schemes, and will put this expertise to use in attracting local firms to participate. They will also be considering, in particular, how to target key local industries along with employers in more fragmented sectors.

3.16 Participating employers will receive subsidies from their local LSC in recognition of their offering all their low-skilled staff paid time off to train. The pilots will test three different levels of compensation for employers, each differentiating between small, medium and large firms. Small firms (those employing less than 50 people) will be paid up to 150 per cent of the average wage costs for low-skilled workers but large firms (those employing more than 250 people) will be expected to bear some or all of the costs of paid time off.

3.17 Independent evaluators at the Institute for Fiscal Studies, together with the Institute for Employment Studies, appointed by DfES, will work with all parties to design an evaluation methodology to assess the pilots. The evaluation will include consideration of the benefits accruing to individuals and employers. Using evidence from matched firms in control areas, and information about the past training activity of firms involved in the pilot schemes, the evaluators will be able to make an assessment of the impact on the training of low-skilled

working people of the four key elements of the pilot model. The 6 pilots will also allow the evaluators to assess the relative impacts of different amounts of time off and levels of financial support for employers. Evidence from the pilots will be considered in conjunction with that from other pilots and research underway to explore workforce development policy options.

THE PILOT MODEL

Free courses for employees working towards their first level 2 qualification

3.18 Credit market failures mean that it is important to ensure that individuals are not dissuaded from training by financial factors. The Government already subsidises training in a variety of ways including extensive course cost subsidies in colleges (including 100 per cent subsidies for basic skills courses with approved providers). Individuals are usually only expected to pay 25 per cent of course costs at other levels in FE colleges. For those on low incomes, however, even modest costs can be prohibitive, and more needs to be done to break down cost barriers for these people. The PIU have cited evidence showing that financial barriers to training affect attainment as well as participation in training, which underlines the importance of financial support to encourage training among those with low incomes. Low skilled working people often earn low wages, so financial support for training is a vital element of the policy approach outlined here.

3.19 The pilots will include free learning up to level 2 for all employees in participating firms who have not yet achieved this standard. Those who need to acquire basic skills as a necessary first step to level 2 will also receive this support, building on basic skills initiatives which already provide free courses and other support for adults with basic skills difficulties.

3.20 Any increased participation in learning may not create a radical change in the prospects of lower-skilled workers if it does not lead to significant increases in the attainment of qualifications. Those without a level 2 qualification will have varied learning needs and will wish to learn in different ways. Recognising this, those training under the pilots will be able to learn using the type of provision most suitable to them. In Essex, for example, the LLSC are keen to develop flexible and customised learning in the workplace where appropriate, and in Tyne and Wear, ICT-based training provision has been identified as a method likely to be effective at reaching those employers and individuals who might not otherwise engage in training. LLSCs will be working with a variety of training providers including FE colleges, community/voluntary training providers and private training providers to deliver the best package of training for the needs of the firms and individuals involved in the pilot schemes.

3.21 The Government will ensure that learning is of good quality by only funding learning undertaken with providers approved by the LSC. The Government will also ensure that training will put individuals in a stronger position in the labour market by only funding learning leading to a recognised qualification.

3.22 The focus of the pilots will be those already in work, since there are already mechanisms in place to support the training of those who are unemployed. Only those without basic skills or level 2 qualifications will be eligible for support in the pilot schemes.

Paid time off to train for low-skilled workers

3.23 Free learning up to level 2 will not be enough on its own to create a step change in training and skills. Take up of courses by low-skilled workers is currently low despite high levels of existing discounts. Survey evidence shows that time constraints are a key reason given by individuals in work for not undertaking training, and the PIU report stressed that low-skilled workers are these most likely to be affected by time barriers to training. 42 per cent of those in paid work say that a lack of time due to work is a key barrier to learning,⁴³ and the importance of time as a barrier is also borne out by surveys in the local LSC areas involved in the pilots.

3.24 The Government views paid time off for those who need to gain basic skills and level 2 qualifications as playing a key role in the policy approach being piloted in the Employer Training Pilots. Low-skilled individuals may have had negative experiences of school and learning, and are thus less likely than others to prioritise education and training in their spare time. For example, according to one study, only 8 per cent of those with no qualifications were considering education/training, compared with 14 per cent of those with level 1 qualifications.⁴⁴

3.25 The Government has already introduced a statutory right to time off for employed 16 and 17 year olds to encourage them to engage in more education and training. The pilots will seek to build on this to encourage life long learning. The Government wishes to learn from the evaluation of the pilots whether paid time off for low-skilled workers will help overcome the time barriers that often prevent people from training. Time off might ease the time pressures on those who choose to train outside of work hours, and provide opportunities for training in working hours. Such arrangements could also help ensure the effectiveness, and minimise the deadweight cost, of any tax credit or other financial support to employers.

3.26 Chapter 2 explored market failures which limit workforce training. Paid time off to train would mitigate the effects of these market failures. Credit market and information failures will become less significant as the opportunity wage cost of training (i.e. the cost of time off work) falls. Labour market failures, which mean that employers are reluctant to train because of a fear of poaching, will be eased if employers are supported to provide time off for learning and if more skilled employees became available.

3.27 The Government recognises that employer support for individuals' training needs to be balanced against the operational needs of the firm. Paid time off in the pilot schemes may be taken in blocks or in more flexible arrangements which are more appropriate to the needs of both employers and learners.

3.28 A major focus of the pilots will be to determine the amount of time off needed to stimulate demand for training among low-skilled workers and to enable them to reach the level 2 standard, and acquire basic skills if necessary. Three pilots will require participating firms to offer their low-skilled employees 35 hours (5 days) off to train per year, the other three will require them to offer 70 hours (10 days) per year.

3.29 The PIU noted that a statutory right to time off for training and development could be a way of overcoming time barriers to training. The pilots will operate on a voluntary basis, but firms will be asked to offer the appropriate minimum amount of time off to all staff without basic skills and level 2 qualifications in order to receive financial support for the training involved. This will allow the Government to explore the impact on training of different amounts of time off. The experiences of participating firms will enable judgements to be made as to the likely impact on the demand for training of an entitlement to time off.

⁴³ Blake and La Valle 2001.

⁴⁴ Beinart and Smith 1998.

Financial support for employers

3.30 Training benefits employers as well as trainees in the long term, but the Government recognises that staff taking time off to train imposes a cost on firms. The potential costs to firms of time taken off for training are:

- the wage costs of staff taking time off to train; and
- the frictional costs of staff taking time off to train (for example the recruitment costs of finding temporary replacement staff).

3.31 The pilots will provide financial support to employers whose staff take time off, in recognition of the costs they will incur. Employers participating in the pilots will be able to claim subsidies towards the wage costs of eligible workers registered with an approved training provider to work towards basic skills or level 2 qualifications. Employers will only be able to claim the support if the employee confirms that they have received appropriate paid time off.

3.32 Small firms face higher costs associated with training for low skilled people for two main reasons:

- small firms face higher frictional costs when staff take time off work, having smaller internal labour markets and more specific jobs in many cases; and
- a higher proportion of staff in small firms have low qualification levels than in larger firms (31.9 per cent of staff in firms employing less than 500 staff as compared to 20.2 per cent in firms employing 500 or more).⁴⁵

3.33 These higher costs are reflected in the fact that small firms tend to provide less training for their staff than larger firms. The PIU have emphasised in their recent report that small firms face significant cost barriers to training and are often constrained by limited cash flow. Additional support for small firms (those employing less than 50 staff), which employ more than 50 per cent of low-skilled workers in the UK, will therefore be important to the success of any new policy.

3.34 In the pilot schemes the Government will recognise the additional burdens on small firms by providing financial support to small firms paid at a higher rate than that paid to large firms. Pilots will provide small firms with financial support of up to 150 per cent of the average wage costs of low-skilled staff for the required period of time off, to cover costs they may face beyond wage costs and provide an additional incentive to them to fully to support the training of their staff.

3.35 Some evidence suggests that training increases productivity more than employee wages, and that firms therefore often make net gains from training. Larger firms participating in the pilot will thus be expected to bear some or all of the costs of low-skilled staff taking time off.

3.36 For the purposes of the pilots, financial support to employers is being administered via a grant mechanism administered by local LLSCs. The pilots will test three different levels of support (each differentiating between small, medium and large firms) to provide information which will allow the Government to ensure that any new national policy offers appropriate and adequate levels of support to employers. The method by which the Government delivers any financial support to employers must minimise the administrative burden on firms, be able to target those employers most in need of support and ensure that firms get the support they need to fully facilitate the training of their staff up to level 2.

⁴⁵ Labour Force Survey.

3.37 The Government remains committed to creating a system whereby employers are rewarded and encouraged when they invest in training for their staff. The Government will continue to work alongside key stakeholders to develop the most effective strategy possible for delivering this support, and will carry out a full regulatory impact assessment and wide consultation on the development and implementation of any new policy.

Box 3.2: Investors in People

The Investors in People (IiP) Standard has been successful in enabling employers to identify the strengths and weaknesses of skills in their organisations and to act strategically to raise skills. Since its launch in 1991, the Standard has successfully established itself in both the private and public sectors, and well over a third of the workforce are now employed in organisations which are recognised as Investors in People or committed to achieving the Standard. Research for the Government, which has yet to be published, has shown that 79 per cent of companies committed to IiP say they have increased the amount of management time spent on HR development, while 61 per cent reported increases in the expenditure on HR development.

Although IiP has proved successful in many ways, take-up is low among smaller organisations. Fewer than 1 per cent of organisations with fewer than 50 employees are currently working with the Standard. One of the three key priorities for raising skill levels identified by last year's skills report of the CBI-TUC to the Government's Productivity Initiative was increasing take-up of IiP by small organisations.

The Government provides financial support to small firms working towards achieving the IiP standard, and is keen that these arrangements be made as effective as possible. Existing support is delivered via LLSCs. The way in which the support for small firms is delivered, and how much support is given, varies locally. The average level of support given to small firms is currently over £4,000. The Government supports a current LSC review of how financial support is distributed locally and how this could be rationalised and clarified. The LSC will work with the CBI-TUC productivity group and others, to help ensure that the money spent on supporting small firms meets the needs of both employees and employers as effectively as possible.

Information, Advice and Guidance

3.38 In their recent report, the PIU explored the importance for workforce development of information, advice and guidance and of networks created to spread best practice. The Government accepts their analysis that improvements in these areas will be crucial to increasing the demand for training from employers (support is especially important to empowering small firms) and individuals. Information, advice and guidance will be a key element of all the pilot schemes.

3.39 LLSCs, SSCs and the Small Business Service, with its Business Links Network, are well placed to provide employers with advice on skill needs. The Government is putting in place improved arrangements for information, advice and guidance, working through Information Advice and Guidance Partnerships, which will be able to do the same for individuals. The Government has thus already begun to develop many of the advice and support facilities individuals and employers will need. Schemes such as Investors in People (see Box 3.2) are already supporting and encouraging employers to train their staff. More needs to be done to ensure that the current arrangements form a unified system, and that they can be easily accessed by those who need them. There are particular challenges associated with effective information and support for low-skilled individuals and small firms.

3.40 It is also important that employers and individuals can access accurate and relevant information to help them to achieve real outcomes from increased skills and training. The pilots will use various methods to provide this information, including training needs assessments (for both employers and individuals) and company/individual action plans; and will deliver this support through a variety of institutions including Business Links, Information, Advice and Guidance Consortia/Partnerships, trade unions and employer organisations. Engaging employers in the pilot schemes will be a key challenge, and the Government looks to the LLSCs involved to ensure that this is done effectively.

3.41 The information, advice and guidance needed by individuals, employers and learning providers to make training policies a success needs to be provided in a variety of ways. The Government has already introduced an effective means for championing learning in the workplace in the form of Union Learning Representatives (ULR). The Government will seek to further develop the role of key workers to provide both employers and employees with help in identifying and meeting their training needs as part of the pilot schemes. Greater Manchester LLSC, for example, will be working with their local TUC branches to develop the ULR model and expand its scope.

3.42 Pilots will test the adequacy of these measures to support those involved in the new scheme, and explore the effectiveness of different models of outreach and provision. The Government will make decisions on the provision of additional information and guidance infrastructure in the light of the outcomes and evaluation of this aspect of the pilot schemes.

CONCLUSION

3.43 The Government is committed to building on the recent work of the PIU and the CBI-TUC to move towards a new national policy framework for training. The Employer Training Pilot schemes will be a new step towards the goals shared by all stakeholders that the UK should have a world-class workforce and that none should be excluded from the training they need to develop and progress.

INTRODUCTION

4.1 If employers, individuals and government are to see an effective return on increased investment in training, a network of high quality training providers is vital. The Government also has a particular responsibility to ensure that publicly funded provision offers value for money.

4.2 In order to create sustainable demand for training it is important to ensure that the training supplied is both of a high quality and responsive to the needs of individuals and employers. Training provision needs to be flexible if it is to remain relevant to the workplace and must be of a high quality in order to encourage employers and individuals to increase their investment in training

4.3 In view of the importance of building an effective network of training providers, the Department for Education and Skills (DfES) has initiated a debate with Further Education (FE) colleges and other providers about how best to develop the quality and responsiveness that are essential in the sector if participation is to be widened, attainment improved and productivity and skills in the economy increased.

THE FRAMEWORK FOR THE SUPPLY SIDE

4.4 Since April 2001, the Learning and Skills Council (LSC), a single body with 47 local arms, has been responsible for co-ordinating, promoting, funding and planning all post-16 education and training outside higher education, focusing particularly on the skills needed by individuals in the workforce and by employers. This offers the opportunity not only to improve the coordination of education/training provision but also to improve the match between supply and demand for adult skills and workforce development. The LSC is developing a national workforce development strategy alongside its wider corporate plan.

4.5 Each of the 47 Local LSCs has produced a medium term skills strategy, reflecting local and sectoral needs, by consulting local employers and Regional Development Agencies (RDAs). Each council has also produced a learning strategy showing how its analysis of skill needs will influence its plans to develop the local education and training infrastructure. Local colleges and other providers will be required to set out, in their application for funds for 2002-03, how their plans will contribute to those skill needs.

4.6 Weaknesses in sectoral skills planning are also being tackled by replacing the current National Training Organisations by a smaller, better-focused and more powerful network of Sector Skills Councils. These will provide an informed voice on sector skills needs and work closely with the LSC and RDAs at national, regional and sub-regional level to influence public planning and funding mechanisms. They are bringing together employers, trade unions and professional bodies to develop a better understanding of the skills that UK business needs. This improved strategic framework for sector skills planning will help post-16 learning providers to provide relevant and up-to-date training to meet the needs of employers.

4.7 But this new framework will only be effective if colleges and other providers of post-16 education are delivering high quality learning and are responsive to labour markets.

4.8 Post-compulsory education and training in the UK outside higher education is carried out by a variety of institutions including schools, private and voluntary sector providers and FE colleges. It is important to maintain this diversity of provision to ensure that learners can receive education and training in an environment which most suits their needs. This chapter focuses on the FE sector in particular because it accounts for the largest numbers of learners in post-16 education (currently providing 54 per cent of all UK vocational qualifications), and is a particularly important source of learning opportunities for low-skilled adults. The Government will also continue to support other providers of post-16 education in ways appropriate to their particular needs.

4.9 The FE sector consists of over 400 institutions,¹ which cater for a diverse range of individual needs including courses and qualifications for those who are progressing to higher education and for those who want to gain new skills for work or leisure. 4 million students attend colleges every year, studying for over 5 million qualifications. Of these students around 80 per cent are adults (although on a full time equivalent basis the 16-18:adult split is around 50:50).

4.10 FE colleges lie at the centre of the Government's ambitions to improve:

- adult basic skills;
- technical and vocational education;
- the skills of young people;
- skills for adults; and
- access to higher education.

The FE sector also has an important role to play in reducing social exclusion by targeting vulnerable groups as well as increasing skills and productivity by responding to the needs of employers and individuals. The Government recognizes the need to support the FE sector to achieve these ambitions, but the sector itself must also rise to the challenge of providing consistently high quality education and training that meets the needs of individuals, communities and employers.

FURTHER EDUCATION PERFORMANCE

4.11 The FE sector has many strengths. There are 18 FE colleges with Beacon status², 16 FE colleges with pathfinder Centres of Vocational Excellence, and 71 colleges have been approved to go forward to the next stage of the Centres of Vocational Excellence programme.³ Over 90 per cent of college teaching is satisfactory or better at inspection and progress has been made on reducing a long tail of poor performances in colleges. In 1997 125 colleges had achievement rates⁴ below 65 per cent; by 2000 this was down to 48 colleges.

4.12 Table 4.1 below shows that average success rates⁵ in FE have improved in recent years. At the same time, the FE sector has delivered year on year efficiency gains. However, success rates must improve further if individuals and employers are to receive a consistently high quality service.

¹ The FE sector includes 6th form colleges, general FE colleges, agricultural and technical colleges, and tertiary colleges.

² Beacon status recognises outstanding teaching and learning practice across the FE curriculum

³ Centres of Vocational Excellence build on existing good practice and provide leadership in the development of excellent provision elsewhere of a certain vocational specialism.

⁴ Achievement rates indicate the proportion of those learners entered for a qualification who achieve it.

⁵ Success rates are a product of retention rates (i.e. the proportion of those enrolling on a programme who complete it) and achievement rates

Table 4.1: Success rates¹ in FE Colleges 1996-9

All Colleges	1996-7	per cent 1997-8	1998-9
16-18	52	55	56
19+	46	50	51

¹ Success rates are a product of retention rates (i.e. the proportion of those enrolling on a programme who complete it) and achievement rates (i.e. the proportion entered for the relevant qualification who pass it).

Source: DfES

4.13 Success rates for 16-18s are significantly better in sixth form colleges than in general FE colleges (66 per cent compared to 53 per cent). However analysis suggests that much of this difference can be explained by the higher average prior attainment of the 16 year olds entering sixth form colleges, rather than by the quality of provision. Adult performance is similar across different types of college.

4.14 The best FE colleges perform very well indeed, with success rates of over 70 per cent. If the performance of the colleges at the lower end of the range could be improved further, this could have significant effects. For example, if the success rates of the bottom 50 per cent of colleges could be brought up to the level of the current median, the impact on average success rates would be close to 5 percentage points. The Government therefore believes that there is still cause to be concerned over the range of performance in the sector, and potential to support those colleges at the bottom end of the performance range to improve their outcomes. Low performing colleges will also have to rise to the challenges necessary to improve their own performance.

4.15 To achieve the step change in performance that is required the sector must be supported by a proper level of investment. In 2002-03 the Learning and Skills Council will have a budget of over £7 billion (a real terms increase of 6 per cent). Funding rates for colleges will be raised by 2.5 per cent for 2002-03 in line with inflation. The simplified post-16 standards fund will provide £185 million in 2002-03 to support college capacity building and underpin development plans in colleges and the wider sector. The Teaching Pay Initiative allows colleges to recognise and reward high quality teaching with increased pay.

4.16 Investment is clearly important for raising standards and to ensure that the FE sector has capital equipment and staff to meet employer and skill needs and match the best in the world. The Government is considering how best to support the FE sector in the context of the Spending Review but, in return, the Government expects to see rapid improvements across the sector.

RAISING STANDARDS AND PERFORMANCE

4.17 Following a debate with the FE sector over the spring and summer, the Department for Education and Skills will announce later this year its proposals for implementing a strategy, supported by the outcomes of the Spending Review, to raise standards and performance and meet employer and skill needs. The LSC will play a central role in contributing to this debate and implementing its conclusions. Key elements of the strategy will need to include matching supply and demand, improving teaching and learning and developing leadership. Action is already under way in these areas.

Matching Supply and Demand

4.18 The setting up of the LSC with its 47 local arms provides the opportunity for the first time to review on a consistent basis how well the pattern of provision meets the local and regional needs of individuals, communities and employers. This process is supported by inspection of colleges and other providers under a new Common Inspection Framework and by area inspections of provision for 16-19 year olds. This has already led to proposals for new colleges or centres and the first new college since the incorporation of the sector in 1993 has been created at Brooke House Sixth Form College in Hackney.

4.19 High quality education and training, particularly in vocational areas, cannot be achieved without high quality and up to date capital infrastructure. The FE capital stock has been allowed to decline and the Government recognises the importance of rectifying this situation, especially in light of the need constantly to update equipment to maintain relevance to the workplace.

Teaching and Learning

4.20 Teachers and lecturers must be at the centre of any improvements to the FE sector. The sector must be able to attract highly skilled and committed professionals and be able to retain these staff. The sector has already been able to make a start on reforming and improving pay arrangements and reversing casualisation through the Teaching Pay Initiative, under which £310 million has already been made available over the three years to 2003-04. The Government will look at this issue as part of the 2002 Spending Review.

4.21 The professional skills of teachers are essential to raising standards. Initial training and continuing professional development are both important and the Standards Fund has already provided new resources to allow colleges to invest in teachers' and lecturers' skills and qualifications. This will be pursued further as a theme of the strategy DfES is developing with the sector.

Leadership

4.22 Poor performing colleges are often associated with weak management. Inspection reports suggest a strong correlation between the quality of management and overall performance. Alongside effective management, college leaders need to provide strategic leadership to ensure that they are well placed to deliver their chosen mission and be responsive to individual, community and employer needs. DfES has already proposed a new national leadership college and a contract for the new college will be awarded in the late autumn of this year with the college up and running and offering its first programmes by April 2003. Developing the sector's leaders of the future will form a key part of the Department's plans for further education.

IMPROVING THE IMPACT OF FE ON SKILL NEEDS

4.23 Local and regional economies need colleges and other post-16 providers that are committed to identifying and meeting their needs as part of their core mission. Too many employers have grown to assume that FE colleges cannot respond to their needs or deliver the training they want, and too many FE colleges are failing to respond effectively to local labour market demands.

4.24 Local Learning and Skills Councils are helping to connect FE colleges to employers and communities in a more systematic way. Other stakeholders such as Regional Development Agencies, the Small Business Service and Business Links are also playing a key role. The Government will continue to play its part in facilitating change, and will encourage employers to make clear their expectations and training needs. UK employers must take seriously the need to engage with the FE sector. Colleges themselves must also commit to working more effectively in partnership with employers in order to identify and meet current and future training needs and drive up demand for the education and training which they deliver.

4.25 Some FE colleges are already demonstrating best practice in their relationships with employers. These colleges, who often have dedicated members of staff for business outreach, are approaching local businesses in order to find out their skill needs, and designing programmes which meet these needs. They are also effectively communicating the range of their existing provision to employers and making clear how programmes are relevant to local needs. More colleges need to take on these best practice models in order to make their provision more responsive to business needs.

4.26 Relationships between FE colleges and employers are generating benefits for both parties including:

- a more detailed understanding of current and likely future skill needs;
- training provision which is up-to-date in specialised content and directly relevant to known workplace needs;
- teaching staff who are enthused because they are making a difference to specific employers as well as to individual students;
- high placement rates into relevant jobs, leading to increased demand for training from people changing jobs or entering the labour market for the first time; and
- greater willingness by employers to invest in workforce development and to pay providers for services which impact directly on their profitability, either in cash or in kind (e.g. staff swaps or paying for/donating equipment).

4.27 It is important that all FE colleges build stronger relationships with business. It will be important to develop measures of achievement in this area in order to both support those colleges which find it difficult to make such links and to recognize the work of those colleges which are leading the way. The Government looks to the LSC, working in partnership with providers and employers, to lead the implementation of the reforms which are necessary, but also looks to FE colleges to spread best practice in this area and develop appropriate relationships for their particular circumstances.

CONCLUSION

4.28 The Government's vision is of a system where demanding challenges to the FE sector are matched with high levels of support and investment. Targeted intervention is needed to put an end to poor provision and to improve provision which is merely adequate, so that all learners receive high quality education and training. High performing FE colleges will be rewarded by Beacon Status, and support will be provided for those colleges that need to improve.

4.29 As previous chapters have demonstrated, it is essential to achieve a step change in UK skills. The Employer Training Pilots outlined in Chapter 3 are a crucial new step in this, but the supply of training is also essential if the UK is to achieve real change. The new framework for the supply side and a more detailed understanding of the factors which support or inhibit success at individual college level is allowing more strategic development of the FE sector. Improved success rates and transformed relationships between providers and local labour markets are needed to make the UK's skills and workforce development system world-class. The Government recognizes the need for such improvements and it is looking at these issues in the context of the 2002 Spending Review. However, the transformation which is required will only come about if FE colleges also rise to the challenge.

5.1 The 2001 Pre-Budget Report announced pilot schemes to test new approaches to skill development in the UK. This paper has set out an analysis of the importance of skills in increasing UK productivity, and explored the potential role of Government intervention in workforce development. It has also set out more details of the new Employer Training Pilots which will explore how intervention can best be targeted to increase the demand for training among low-skilled workers, and the Government's vision of a training supply-side to meet this demand.

5.2 The UK productivity gap is partly explained by the relative weakness of UK skills. The UK compares particularly unfavourably to European countries in terms of low and intermediate skills – the UK has a much larger proportion of workers who are unskilled or who have very few qualifications.

5.3 The skills of the workforce are improving, but current rates of improvement will not be enough to close the skills gap. The distribution of training in favour of those who already have high skill levels reinforces the problem. The economy will not maximise its long term growth potential, and UK society cannot be inclusive, if over a third of the workforce have few or no skills and qualifications. A step change in the training opportunities of low-skilled workers is needed. The Employer Training Pilots will be a new step towards the goals shared by all stakeholders that the UK should have a world-class workforce and that none should be excluded from the training they need to develop and progress.

5.4 As outlined in the 2001 Pre-Budget Report the policy approach being tested by the new pilot schemes consists of four complementary, linked elements based on shared responsibilities between employers, individuals and government:

- (i) free learning provision and accreditation for employees without basic skills or level 2 qualifications, to work towards recognised qualifications up to the level 2 standard (including basic skills), with approved providers. This would build on the current provision of free courses for basic skills under the Government's *Skills for Life* initiative;
- (ii) some form of arrangement for individuals to take up training – such as a minimum entitlement for all employees who have not attained basic skills or level 2 qualifications to paid time off each year to train towards the level 2 standard. The Government will explore different possible time periods in the pilots;
- (iii) financial support for employers whose staff take time off to train to acquire basic literacy, numeracy and ICT skills and to progress to level 2, with additional financial incentives for small firms. This financial support could be delivered through a tax credit or other mechanism. The Government will consult on these options, which will be developed jointly with DfES and alongside the wider work of the PIU, and will explore different levels of compensation in the pilots; and
- (iv) extended information, guidance and support for employers and individuals taking part in, or considering taking part in, any new system. Among other possibilities, these could include the wider deployment of 'Skills Champions' along the lines of Union Learning Representatives, which have proved successful in breaking down individual and employer barriers to skill development.

5.5 The Employer Training Pilots in Birmingham and Solihull, Derbyshire, Essex, Greater Manchester, Tyne and Wear, and Wiltshire and Swindon will provide information about how the key policy proposals outlined above would impact on UK skills.

5.6 If new policies successfully raise the demand for training, the UK needs a high quality and responsive supply of training. This paper has outlined the crucial role of the FE sector in particular in providing this, and emphasised the importance of improved success rates and transformed relationships between FE colleges and local labour markets. It has also set out a strategic framework for delivering improved FE performance, underlined the Government's commitment to supporting change and improvement in the FE sector, and presented challenges to the sector itself to adapt and improve its delivery of education and training.

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